

## Internal Revenue Service

Number: **200841019**

Release Date: 10/10/2008

Index Number: 115.00-00

Department of the Treasury

Washington, DC 20224

[Third Party Communication:

Date of Communication: Month DD, YYYY]

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PLR-113166-08

Date:

July 07, 2008

### LEGEND:

State =

Plan =

Trust =

Trust Agreement =

Board of Trustees =

Program Administrator =

Statute I =

Statute II =

Statute III =

Statute IV =

Date =

Dear \_\_\_\_\_ :

This is in response to a letter dated October 1, 2007, requesting a ruling that: (1) the income of Trust is excludable from gross income under section 115(1) of the Internal Revenue Code (Code); and (2) Trust is not required to file an annual federal income tax return.

ISSUE 1 -- SECTION 115(1)

FACTS:

Plan is a statewide system established under Statute I to administer retirement plans and other funds which provide medical, death, disability and retirement benefits on behalf of active and former State employees, teachers, State police and firefighters, judges, and volunteer firefighters. Pursuant to Statute I, Plan is administered by a Board of Trustees that is comprised of seven members, both appointed and ex-officio, including the Secretary of Finance and Director of Office of Management.

Trust was established by State pursuant to Statute II, to assist State in the payment of premiums for health benefits provided to eligible retirees and their eligible spouses and dependants. Eligible pensioners include individuals formerly employed as State employees, teachers, judges, police, and individuals eligible to receive a premium or subscription charge payment from State pursuant to Statute III. Trust Agreement became effective on Date and was adopted by Board of Trustees, which will also serve as trustees to Trust. In accordance with Statute IV, Trustees caused a certificate of trust to be filed with the Office of the Secretary of State, following execution of Trust Agreement. Trust provides these benefits through Plan. Program Administrator will assist Board in carrying out its responsibilities.

Trust serves as a method of accumulating funds to make future disbursements by State. Trustee will invest and reinvest Trust's funds and pay benefits from Trust at the direction of Program Administrator solely to provide insured health benefits to pensioners, their spouses and dependents. For certain retirees and beneficiaries, State's liability for the cost of benefits does not include the full cost of the health benefits provided. Both eligibility and costs of benefits vary based on the hire date, years of service upon retirement, and whether the retiree or beneficiary is Medicare-eligible.

State represents that there is no cash-out of any amounts paid for benefits and no conversion of sick or vacation days to post-retirement health benefits. State also represents that benefits may not be paid by pre-tax salary reduction.

State agrees that in administering Plan; State will make reasonable efforts to identify individuals who do not qualify as dependents (under section 152 of the Internal

Revenue Code ("Code")) of retirees who participate in Plan and will, in accordance with applicable law, include in the income of retirees the value of State's portion of coverage of such individuals.

Trustees of Plan act as Trustees of Trust and have exclusive control of Trust. Trustees may also modify design of Trust at any time and in any manner in accordance with applicable State laws and not inconsistent with applicable Governmental Accounting Standards Board (GASB) Statement No. 43 and 45, or section 115(1) of the Internal Revenue Code ("Code"). Monies contributed to Trust utilized by Trustees at the direction of the Plan Administrator to help pay the cost of providing insured health benefits to pensioners, their spouses and dependents. In accordance with section 115(1), upon dissolution of Trust and after payment of all of Trust's liabilities, any remaining property will be distributed by Trustees for the sole purpose of assisting in the payment of State's premiums for post retirement health insurance for pensioners and their eligible spouses and dependents, fees, and allocated administrative fees and expenses. Trust will thereby terminate and Trustees shall cause an appropriate form of certificate of cancellation to be filed in State's Office of the Secretary of State.

#### LAW AND ANALYSIS:

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision of a state.

Under Rev. Rul. 77-261, 1977-2 C.B. 45, the income from an investment fund, established under a written declaration of trust by a state for the temporary investment of cash balances of the state and its political subdivisions, was excludable from gross income for federal income tax purposes under section 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utilities or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under section 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust provides insured health benefits to eligible retired State employees and their dependents. Providing health benefits to current and former employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of section 115(1) of the Code.

The income of Trust accrues to the benefit of State. Trust's assets will be used only for administrative expenses and expenditures in providing health care benefits to eligible participants. No private interests participate in or benefit from the operation of Trust. Any distribution of remaining funds in Trust to participating employees upon the dissolution of Trust satisfies an obligation State has assumed with respect to providing health benefits to State employees. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Based on the information and representations submitted, we hold that the income of Trust is derived from the exercise of an essential governmental function and will accrue to a political subdivision thereof for the purposes of section 115(1). Accordingly, Trust's income is excludable from gross income under section 115(1) of the Code.

#### ISSUE 2 -- SECTION 6012(a)(4)

##### FACTS:

Article II, Section 2.04(a) of Trust Agreement provides that the Trustees shall receive and accept all contributions and shall hold, invest, reinvest, manage, administer, and distribute property and the increments, proceeds, earnings, and income solely to provide health and welfare benefits to pensioners and their eligible spouses and dependents.

Article II, Section 2.04(j) of Trust Agreement provides, in general, that no portion of the principal or income of Trust shall revert to the State, or shall be used for or diverted to any purpose other than to provide post-retirement health and welfare benefits to pensioners and their eligible spouses and dependents.

Article III, Section 3.01 of Trust Agreement provides, in general, that contributions to Trust consist solely of State appropriations and other employer contributions deposited by the State. Section 3.02 provides that disbursements from Trust are to be made for the sole purpose of assisting in the payment of the State's premiums for post-retirement health insurance for pensioners and their eligible spouses and dependents (and for reasonable expenses and fees), and that any amounts remaining in Trust after such disbursements are made are to be retained in Trust for future payments, until all State liabilities for post-retirement health insurance premium benefits have been satisfied.

Article V of Trust's governing instrument sets forth the powers and duties of the Trustees.

#### LAW AND ANALYSIS:

Section 301.7701-1(b) provides, in part, that the classification of organizations that are recognized as separate entities is determined under Treas. Reg. §§ 301.7701-2, 301.7701-3, and 301.7701-4, unless a provision of the Code provides for special treatment of that organization.

Section 301.7701-4(a) provides that, in general, an arrangement will be treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

State contributes money to Trust to assist with the payment of the State's premiums for post-retirement health insurance for pensioners and their eligible spouses and dependents. Trustees of Trust are charged with protecting and conserving Trust's assets for beneficiaries who cannot share in the discharge of this responsibility, and therefore, are not associates in a joint enterprise for the conduct of business for profit. Assuming Trust is recognized as a separate entity under § 301.7701-1, we conclude that Trust is an ordinary trust under § 301.7701-4(a).

Section 6012(a)(4) provides that every trust having for the taxable year any taxable income or having gross income of \$600 or over, regardless of the amount of taxable income, shall make returns with respect to income taxes under Subtitle A. Accordingly, Trust will not be required to file an annual income tax return under section 6012(a)(4).

#### RULINGS

1. Based on the information and representations submitted by the taxpayer, we that the income of Trust is derived from the exercise of an essential governmental function and will accrue to State. Accordingly, Trust's income is excludable from gross income under section 115(1) of the Code.
2. Trust is classified as a trust under the provisions of § 301.7701-4(a). Section 6012(a)(4) does not require Trust to make returns of income when gross income is not \$600 or over. Because Trust's income is excludable from gross income under section 115(1), Trust will not be required to file an annual income tax return under section 6012(a)(4).

No opinion is expressed or implied concerning the federal tax consequences of Trust under any other provision of the Code other than those specifically cited above. In particular, no representation is made regarding the federal tax consequences of contributions to or payments from Plan including (but not limited to) whether contributions to Plan are excludable from gross income of employees, former employees or retirees under section 106 and whether payments from Plan are excludable from the gross income of employees or retirees under sections 104 or 105.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

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Sylvia F. Hunt  
Chief, Exempt Organizations Branch 2  
Division Counsel/Associate Chief Counsel  
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter  
Copy for § 6110 purposes